Nos. 06-1454, 06-1457, 06-1462 and 06-1468

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In The
Supreme Court of the United States

SEMPRA GENERATION, *et al.*,

Petitioners,

v.

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA, *et al.*,

Respondents.

[Captions Continued On Inside Cover]

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

BRIEF IN OPPOSITION OF THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA AND CALIFORNIA ELECTRICITY OVERSIGHT BOARD

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MORGAN STANLEY CAPITAL GROUP INC.,

Petitioner,

v.

PUBLIC UTILITY DISTRICT NO. 1 OF SNOHOMISH COUNTY WASHINGTON, *et al.*,

Respondents.

CALPINE ENERGY SERVICES, L.P., *et al.*,

Petitioners,

v.

PUBLIC UTILITY DISTRICT NO. 1 OF SNOHOMISH COUNTY WASHINGTON, *et al.*,

Respondents.

DYNEGY POWER MARKETING, INC., *et al.*,

Petitioners,

v.

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA, *et al.*,

Respondents.

PARTIES TO THE PROCEEDINGS BELOW

Respondents Public Utilities Commission of the State of California ("CPUC") and California Electricity Oversight Board ("CEOB") were petitioners in *Public Utilities Commission of California v. FERC*, 474 F.3d 587 (9th Cir. 2006) ("*PUC*"), and complainants in the underlying proceeding before the Federal Energy Regulatory Commission ("FERC" or the "Commission"). Respondents also intervened in *Public Utility District No. 1 of Snohomish County Washington v. FERC*, 471 F.3d 1053 (9th Cir. 2006) ("*PUD*"). This brief responds to the petitions seeking this Court's review of the decisions in *PUC* and *PUD*. References herein to the Ninth Circuit's opinion are to *PUD* unless otherwise indicated.[1]

[1] Unless otherwise noted, all references to "Dynegy Pet." and "Pet. App." are to the petition and appendix filed in No. 06-1468. All references to "Sempra Pet." are to the petition filed in No. 06-1454; all references to "MSCG Pet." are to the petition filed in No. 06-1457 and all references to "Calpine Pet." are to the petition filed in No. 06-1462.

TABLE OF CONTENTS

	Page
STATEMENT OF THE CASE	1
1. The Federal Power Act	1
2. *Mobile* and *Sierra*	1
3. The Change to "Market-Based" Regulation	3
4. The Collapse of the Western Electricity Markets	4
5. The Subject Contracts	6
6. FERC's Rulings	7
7. The Ninth Circuit's Decisions	9
REASONS TO DENY THE PETITIONS	11
I. THE NINTH CIRCUIT'S DETERMINATION THAT THERE MUST BE AT LEAST ONE OPPORTUNITY TO REVIEW A CONTRACT'S JUSTNESS AND REASONABLENESS DOES NOT CONFLICT WITH PRECEDENT FROM THIS COURT OR ANY CIRCUIT	11
II. THE NINTH CIRCUIT DID NOT CREATE A CONFLICT WITH THE D.C. CIRCUIT IN HOLDING THAT THE GRANT OF MARKET-BASED RATE AUTHORITY WITHOUT ON-GOING EFFECTIVE MARKET OVERSIGHT DOES NOT SATISFY THE FPA'S REQUIREMENT OF AN OPPORTUNITY FOR A JUST AND REASONABLE REVIEW	15
III. THE NINTH CIRCUIT'S DECISIONS DO NOT CONFLICT WITH *MOBILE* AND *SIERRA* OR CREATE A SPLIT IN THE CIRCUITS AS TO HOW THE PUBLIC INTEREST STANDARD APPLIES TO A MARKET-BASED CONTRACT GOVERNED BY THE FPA	19

TABLE OF CONTENTS – Continued

Page

IV. REVIEW OF THE NINTH CIRCUIT'S DECISIONS AT THIS TIME WOULD BE INAPPROPRIATE FOR PRUDENTIAL REASONS..... 26

CONCLUSION..... 30

TABLE OF AUTHORITIES

Page

CASES

Arkansas Louisiana Gas Co. v. Hall, 453 U.S. 571 (1981) 2, 12

Belco Petroleum Corp. v. FERC, 589 F.2d 680 (D.C. Cir. 1978) 25

Borough of Lansdale v. FPC, 494 F.2d 1104 (D.C. Cir. 1974) 13, 22

Boston Edison Co. v. FERC, 233 F.3d 60 (1st Cir. 2000) 20

California, ex rel., Lockyer v. FERC, 383 F.3d 1006 (9th Cir. 2004), *cert. denied*, 551 U.S. __ (June 18, 2007) 5, 17

In re California Power Exchange Corp., 245 F.3d 1110 (9th Cir. 2001) 5

Compania de Gas de Nuevo Laredo, S.A. v. FERC, 606 F.2d 1024 (D.C. Cir. 1979) 13

Elizabethtown Gas Co. v. FERC, 10 F.3d 866 (D.C. Cir. 1993) 16, 17

FPC v. Sierra Pacific Power Co., 350 U.S. 348 (1956) ..... *passim*

FPC v. Texaco, Inc., 417 U.S. 380 (1974) 1, 17, 18

Farmers Union Central Exchange v. FERC, 734 F.2d 1486 (D.C. Cir. 1984) 17

Interstate Natural Gas Associate of America v. FERC, 285 F.3d 18 (D.C. Cir. 2002) 17, 26, 27

Lackley v. Texas, 514 U.S. 1045 (1995) 29

TABLE OF AUTHORITIES – Continued

Page

Lewis v. Continental Bank Corp., 494 U.S. 472 (1990) 14

Natural Gas Pipeline Co. v. Harrington, 246 F.2d 915 (5th Cir. 1957) 13

Northeast Utilities Service. Co. v. FERC, 993 F.2d 937 (1st Cir. 1993) 13

Northeast Utilities Service Co. v. FERC, 55 F.3d 686 (1st Cir. 1995) 21

Pennsylvania Water & Power Co. v. FPC, 343 U.S. 414 (1952) 1

Potomac Electric Power Co. v. FERC, 210 F.3d 403 (D.C. Cir. 2000) 24

Public Utilities Commission of California v. FERC, 462 F.3d 1027 (9th Cir. 2006) 17

Rice v. Sioux City Memorial Park Cemetery, Inc., 349 U.S. 70 (1955) 14

Silver v. New York Stock Exchange, 373 U.S. 341 (1963) 28

Sam Rayburn Dam Electric Cooperative v. FPC, 515 F.2d 998 (D.C. Cir. 1975) 12, 13

South Carolina Generating Co. v. FPC, 249 F.2d 755 (4th Cir. 1957) 22, 25

South Carolina Generating Co. v. FPC, 356 U.S. 912 (1958) 23

Sunray Mid-Continent Oil Co. v. FERC, 364 U.S. 137 (1960) 25

Tejas Power Corp. v. FERC, 908 F.2d 998 (D.C. Cir. 1990) 27

TABLE OF AUTHORITIES – Continued

Page

Texaco Inc. v. FERC, 148 F.3d 1091 (D.C. Cir. 1998) 20

United Gas Pipe Line Co. v. Mobile Gas Serv. Corp., 350 U.S. 332 (1956) ..... *passim*

Virginia Military Institute v. United States, 508 U.S. 946 (1993) 29

Verizon Communications, Inc. v. FCC, 535 U.S. 467 (2002) 3, 12

Watt v. Alaska, 451 U.S. 259 (1981) 23

STATUTES

Federal Power Act, 16 U.S.C. §§ 791a-828r 1

16 U.S.C. § 824d 2, 14

16 U.S.C. § 824d(a) 1

16 U.S.C. § 824d(c) 3

16 U.S.C. § 824d(e) 3, 25

Natural Gas Act, 15 U.S.C. §§ 717-717z 2

Ca. Water Code § 80104 7

ADMINISTRATIVE MATERIALS

18 C.F.R. § 35.2(d) 3

18 C.F.R. § 35.3 3

18 C.F.R. § 35.8 3

CAlifornians for Renewable Energy, Inc. v. California Public Utilities Commission, 119 FERC ¶ 61,058 (2007) 27, 28

El Paso Electric Co., 108 FERC ¶ 61,071 (2004) 4, 14

TABLE OF AUTHORITIES – Continued

Page

FERC Order No. 888, 61 Fed. Reg. 21,540 (May 10, 1996) 3

GWF Energy LLC, 97 FERC ¶ 61,297 (2001) 4, 14

Ocean State Power, 44 FERC ¶ 61,261 (1988) 3

Market-Based Rates for Wholesale Sales of Elec. Energy Capacity and Ancillary Servs. by Pub. Utils., 119 FERC ¶ 61,295 (2007) 27

San Diego Gas & Electric Co. v. Sellers of Energy & Ancillary Services, 93 FERC ¶ 61,121 (2000) 5

San Diego Gas & Electric Co. v. Sellers of Energy & Ancillary Services, 93 FERC ¶ 61,294 (2000) 5, 6, 9

San Diego Gas & Electric Co. v. Sellers of Energy & Ancillary Services, 95 FERC ¶ 61,418 (2001) 6

Southern Co. Services, Inc., 75 FERC ¶ 61,130 (1996), *aff'd on reh'g*, 87 FERC ¶ 61,214 (1999) 4

MISCELLANEOUS

Application of Sempra for Market-Based Rates, Docket No. ER01-1178-000 (Feb. 6, 2001) 18

Oversight Hearing on the Monetary Policy Report to Congress Pursuant to the Full Employment and Balanced Growth Act of 1978 Before the S. Comm. on Banking, Housing, and Urban Affairs, 107th Cong. 44 (July 16, 2002) (Statement of Alan Greenspan, Chairman of the Board of Governors of the Federal Reserve System) 28

South Carolina Generating Co. v. FPC, Docket No. 57-697, Brief of the Federal Power Commission in Opposition (February 13, 1958) 23

TABLE OF AUTHORITIES – Continued

Page

Supplemental Submission of Evidence and Request for Relief of the California Electricity Oversight Board and the California Public Utilities Commission (March 3, 2003) 8

STATEMENT OF THE CASE

1. The Federal Power Act.

Congress enacted the Federal Power Act ("FPA"), 16 U.S.C. §§ 791a-828r, in order to protect the public interest by ensuring that consumers do not bear excessive rates. *See Pennsylvania Water & Power Co. v. FPC*, 343 U.S. 414, 418 (1952) ("A major purpose of the whole Act is to protect power consumers against excessive prices."). To this end, the FPA commands:

> All rates and charges ... for or in connection with ... the ... sale of electric energy subject to the jurisdiction of the Commission ... shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful.

16 U.S.C. § 824d(a) (FPA § 205(a)).

The FPA "makes unlawful all rates which are not just and reasonable, and does not say that a little unlawfulness is permitted." *FPC v. Texaco, Inc.*, 417 U.S. 380, 399 (1974) ("*Texaco*").

2. *Mobile* and *Sierra*.

In 1956, this Court both confirmed Congress's intention to secure the public's interest in just and reasonable rates, and distinguished that public interest from the private interests of companies contracting to buy and sell wholesale power between themselves. *See United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332 (1956) ("*Mobile*"); *FPC v. Sierra Pac. Power Co.*, 350 U.S. 348

(1956) ("*Sierra*").[2] "[T]he purpose of the power given the Commission ... is the protection of the public interest, as distinguished from the private interests of the utilities...." *Sierra*, 350 U.S. at 355. In each case, the Court considered the following scenario: A private seller and a private buyer entered into a contract for the purchase and sale of gas or power for a period of time at specified rates; the contract was filed with the Federal Power Commission ("FPC"), FERC's predecessor, under FPA § 205, 16 U.S.C. § 824d, which provides a formal opportunity "upon complaint or upon [FERC's] own initiative" to challenge the contract before it takes effect; the FPC accepted the contract for filing; and the seller later sought unilaterally to raise the filed contract rates. The Court found nothing in the FPA (or the NGA) to authorize the FPC to allow unilateral increases in the rates above those specified in the previously filed contracts merely to protect the "private interests" of sellers who decided that the agreed-upon rates had become too low. *Sierra*, 350 U.S. at 355 (a private contract between two companies "may not be said to be either 'unjust' or 'unreasonable' simply because it is unprofitable to the public utility").

The FPC nevertheless retained full authority to review all wholesale power contracts and to modify them where the contract would "adversely affect the public interest," such as "cast[ing] upon other consumers an excessive burden." *Id.*

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[2] *Mobile* construes the Natural Gas Act, 15 U.S.C. §§ 717-717z ("NGA"); *Sierra*, the sister provisions of the FPA. This Court "cite[s] interchangeably decisions interpreting the pertinent sections of the two statutes." *Arkansas La. Gas Co. v. Hall*, 453 U.S. 571, 577 n.7 (1981) ("*Arkla*").

3. The Change to "Market-Based" Regulation.

Until the 1980s, FERC determined the justness and reasonableness of rates primarily on a cost-of-service basis: rates were matched "to the cost to the utility of providing the service, including 'the cost of prudently invested capital used to provide the service.'" Pet. App. at 254a (quoting *Verizon Communications Inc. v. FCC*, 535 U.S. 467, 485 (2002) (*"Verizon"*)). In a cost-based regime, FERC and any affected parties (including consumers and state commissions) had a meaningful opportunity to challenge the contract rates because the contracts themselves had to be filed at least 60 days prior to commencement of service, *see* 16 U.S.C. § 824d(c); 18 C.F.R. §§ 35.2(d), 35.3, 35.8, and FERC could suspend their effectiveness for five months pending review. *See* 16 U.S.C. § 824d(e).

By the late 1980s, FERC moved to an entirely new, so-called "market-based" regulatory regime. The theoretical underpinning of this market-based regime is that a competitive market will by its nature produce just and reasonable rates. *See, e.g.*, *Ocean State Power*, 44 FERC ¶ 61,261 (1988). Under this scheme, FERC authorized a particular seller to engage in market-based sales after FERC determined that the seller lacked market power – a conclusion based on an analysis of the seller's generation or transmission ownership and the availability of open-access transmission services in the relevant market. Pet. App. at 258a (citing FERC Order No. 888, 61 Fed. Reg. 21,540 at 21,553 (May 10, 1996)).

FERC's new regime, based on an *ex ante* assumption that the rates would be reasonable, provided no opportunity for the public to seek review of individual market-based

rate agreements before they became effective. *See, e.g., El Paso Elec. Co.*, 108 FERC ¶ 61,071 at 61,372 (2004). Instead, once authorized, market-based sellers could enter into, and provide service under, power contracts without prior review by FERC. *See, e.g., Southern Co. Servs., Inc.*, 75 FERC ¶ 61,130 (1996) ("*Southern*"), *aff'd on reh'g*, 87 FERC ¶ 61,214 (1999). Short-term transactions (less than one year) could be reported quarterly; long-term agreements (of a year or more) had to be filed within 30 days after service commenced. *Southern*, 75 FERC at 61,444-45. Individual long-term agreements filed *ex post facto* with the Commission were submitted for "informational" purposes only, and were not treated as traditional FPA § 205 filings. Third parties could not intervene and challenge the justness and reasonableness of the rates. *See GWF Energy LLC*, 97 FERC ¶ 61,297 at 62,391 (2001) ("[T]he filing of such agreements does not serve as a vehicle to challenge the justness and reasonableness of either the agreements themselves or the underlying market-based rate authority.").

4. The Collapse of the Western Electricity Markets.

Starting in the late spring of 2000 and continuing for over a year, the markets for wholesale electricity in California (and elsewhere in the West) essentially stopped performing as competitive, or even functioning, markets. Wholesale rates for electricity in California and the West skyrocketed from historic norms of $34 per megawatt hour ("MWh") to in excess of $3,000/MWh; the California investor-owned utilities lost their creditworthiness (with the largest going bankrupt), and the California Independent System Operator ("ISO"), which was responsible for the stability of the regional grid, was forced to declare

dozens of system emergencies, resulting in rolling black-outs across California. *See generally In re Cal. Power Exch. Corp.*, 245 F.3d 1110, 1114-15 (9th Cir. 2001); *see also California, ex rel., Lockyer v. FERC,* 383 F.3d 1006, 1009 (9th Cir. 2004), *cert. denied,* 551 U.S. ___ (June 18, 2007) ("*Lockyer*"); (Excerpts of Record ("ER-__") at 73, 116, 141, 158, 259, 263-69).

Following a Commission-directed Staff investigation, on November 1, 2000, the Commission concluded that the California markets were "seriously flawed": "there is clear evidence that the California market structure and rules provide the opportunity for sellers to exercise market power when supply is tight and can result in unjust and unreasonable rates under the FPA." *San Diego Gas & Elec. Co. v. Sellers of Energy & Ancillary Servs.*, 93 FERC ¶ 61,121 at 61,349-50 (2000).

Because it deemed over-reliance on the spot market to be a significant flaw, FERC in a subsequent order "strongly urge[d]" California market participants to enter into long-term energy contracts (also called forward contracts). *San Diego Gas & Elec. Co. v. Sellers of Energy & Ancillary Servs.* 93 FERC ¶ 61,294 at 61,984, 61,993 (2000) ("December 15, 2000 Order"). A forward contract is a contract to buy and sell power that will be generated and delivered on a future date. (ER-145-46.) Forward prices reflect whatever factors may be thought likely to affect future spot market prices, without regard to the legitimacy of those factors. (ER-149-50, 295.) If the market is not functioning and the exercise of market power raises spot prices, forward prices also will rise unless sellers and buyers believe that the conditions allowing the exercise of

market power will quickly disappear. (ER-257.)[3] Recognizing that urging market participants to enter forward contracts had the potential to create a sellers' forward market, the Commission committed to "be vigilant in monitoring the possible exercise of market power" and "monitor prices in those [forward] markets" in order "[t]o address concerns about potentially unjust and unreasonable rates." December 15, 2000 Order, 93 FERC at 61,994.

5. The Subject Contracts.

On January 17, 2001, after the investor-owned utilities had become uncreditworthy, the Governor declared a State of Emergency and ordered that the California Department of Water Resources ("CDWR") "shall enter into contracts . . . for the purchase of electricity . . . as expeditiously as possible." (ER-77.) In the period between February 6 and August 23, 2001, CDWR executed 57 long-term power contracts, including those that remain at issue.[4] The prices in each of the contracts, which run as high as $249/MWh, reflected the expectation that the noncompetitive spot prices resulting from the market dysfunctions were likely to continue for the summer of 2001 and beyond. (ER-107, 413-26.)

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[3] Before the crisis abated, FERC expressly recognized this "critical interdependence among the prices in the ISO's organized spot markets, the prices in the bilateral spot markets in California and the rest of the West, and the prices in forward markets." *San Diego Gas & Elec. Co. v. Sellers of Energy & Ancillary Servs.*, 95 FERC ¶ 61,418 at 62,547 (2001).

[4] The contracts in dispute in the *PUC* proceeding are between CDWR and Dynegy Power Marketing, Inc. ("Dynegy"), Coral Power, LLC ("Coral"), Sempra Energy Resources ("Sempra") and PacifiCorp Power Marketing ("PPM").

Under California law, California's ratepayers must bear – directly – the rates of the CDWR contracts. Cal. Water Code § 80104 (2001) ("Upon the delivery of power to them, the retail end use customers shall be deemed to have purchased that power from [CDWR]. Payment for any sale shall be a direct obligation of the retail end use customer to [CDWR]."). Unless redressed, California consumers will be burdened with rates that exceed just and reasonable levels by at least $1.4 billion from just the four contracts remaining at issue. (ER-429-30.)

6. FERC's Rulings.

In February 2002, Respondents filed complaints under FPA § 206 asking FERC to determine whether the CDWR contracts, from the outset, were just and reasonable. Pet. App. at 18a-19a (¶ 1), 35a (¶ 35). Contrary to what Petitioners repeatedly state or imply, *see, e.g.*, Dynegy Pet. at 8, Respondents did not argue (and have never argued) that the CDWR contracts, even if just and reasonable when signed, could nevertheless later be modified merely because rates dropped. *See, e.g.*, Pet. App. at 279a.

Notwithstanding the known market dysfunction in California and its previously stated commitment to address concerns about unreasonable prices in the forward contracts entered during the crisis, FERC denied California ratepayers any relief, ruling:

a. The "grant of market-based rate authority constitutes what is known as the 'initial review' of rates." *Id.* at 34a (¶ 35).

b. By granting market-based authority to a seller, "the Commission pre-determines under Section 205 of the FPA that sales at

market-based rates will be just and reasonable." *Id.* (¶ 34).

c. Respondents are not entitled to "another opportunity to argue that the rate was not just and reasonable at the outset." *Id.* at 35a (¶ 35).

d. Under the "*Mobile-Sierra* standard of review," a party must "show that a unilaterally proposed change is required by the public interest." *Id.* at 37a (¶ 40); *see also id.* at 25a (¶ 16), 44a (¶ 52).

e. A party cannot avoid this burden by "claiming that the rates were not just and reasonable when it signed the contract, unless there is evidence such as the seller fraudulently inducing the buyer to execute the contract." *Id.* at 33a (¶ 33).

f. "[A] finding that the unjust and unreasonable spot market prices caused forward bilateral prices to be unjust and unreasonable would be relevant to contract modification only where there is a 'just and reasonable' standard of review. As we have concluded, the contracts at issue in this proceeding do not provide for such a standard but rather evidence an intent that the contracts may be changed only pursuant to the 'public interest' standard of review." *Id.* at 91a (¶ 37).[5]

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[5] In its "Final Report on Price Manipulation in Western Markets," FERC Staff found that the spot market dysfunctions along with tight supply fostered conditions such that numerous market participants, including Petitioners Dynegy, Sempra and Coral, were able, and did in fact, repeatedly game both the gas and electricity markets to artificially inflate prices. (ER-531-71); Supplemental Submission of Evidence and

(Continued on following page)

7. The Ninth Circuit's Decisions.

The Ninth Circuit found this approach to market oversight at odds with FERC's mandate under the FPA to ensure that the public is not burdened with unjust and unreasonable rates. Presented with contracts whose rates were never subject to review by FERC for justness and reasonableness under its market-based rate regime, whose fairness was instead predicated on an admittedly faulty assumption that they were the product of a functioning and competitive market, and whose costs would be borne directly by the public, the Ninth Circuit vacated FERC's

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Request for Relief of the California Electricity Oversight Board and the California Public Utilities Commission (March 3, 2003) at 19-22. These anticompetitive practices, including economic withholding, inflated bidding, wash trades, false data reporting to published price indices and the infamous Enron trading strategies with names like Death Star, Fat Boy and Get Shorty, led in part to the extraordinarily high spot market prices for natural gas and electricity during 2000 and 2001. *Id.* This in turn significantly affected forward prices. The Staff estimated the distortion of forward prices at upwards of $50/MWh (or 33%) for contracts, like Dynegy, of one to four years duration that began delivery in 2001. (ER-582-83, 589, Table V-6.)

FERC, however, ruled that the Staff's findings were not relevant under its formulation of the public interest standard. Pet. App. at 59a, 90a. FERC also affirmed the administrative law judge's prohibition of any discovery as to the Petitioners' participation in the widespread market manipulation in the California spot markets and the impact that manipulation had on forward prices and the judge's exclusion from evidence of the same on relevance grounds. Pet. App. at 85a.

These rulings undermine FERC's finding that Respondents failed to demonstrate any market manipulation "specific" to the contracts at issue. FERC's conclusion in this regard also ignores how markets work. Since the California electricity markets were dysfunctional such that "even small suppliers" were able to inflate prices above competitive levels, all sellers benefited irrespective of their behavior at the bargaining table. *See San Diego Gas & Elec.*, 93 FERC at 61,367.

decision, and remanded for further consideration. In so doing, the court opined in pertinent part as follows:

a. The court agreed with FERC that it may "adopt a regulatory regime that differs from the historical cost-based regime of the energy market," and that "market-based rate authority may be a tenable choice if sufficient safeguards are taken to provide sufficient oversight." Pet. App. at 295a.

b. The court agreed with FERC that, whatever regulatory scheme it adopts, it must provide "an opportunity for initial review of whether a rate is just and reasonable." *Id.* at 278a.

c. The court disagreed with FERC that the then-extant regulatory regime necessarily provided an opportunity for initial review. *Id.* at 291a-95a.

d. The court ruled that if the contract rates at the outset were so high as to be outside the zone of reasonableness, then they adversely affect the public interest and are subject to modification under the FPA. *Id.* at 302a-03a; *PUC*, Pet. App. at 12a.

REASONS TO DENY THE PETITIONS

I. THE NINTH CIRCUIT'S DETERMINATION THAT THERE MUST BE AT LEAST ONE OPPORTUNITY TO REVIEW A CONTRACT'S JUSTNESS AND REASONABLENESS DOES NOT CONFLICT WITH PRECEDENT FROM THIS COURT OR ANY CIRCUIT.

Petitioners argue that the Ninth Circuit created a conflict meriting review when it agreed with FERC that the FPA requires at least one opportunity for the review of the justness and reasonableness of rates.[6] Dynegy Pet. at 13-14; Sempra Pet. at 14-17. There is no such conflict.

In both *Mobile* and *Sierra*, the issue was whether the Commission could allow the seller in an energy contract unilaterally to raise the rates that had been previously agreed upon and accepted by the Commission. In each case, the pre-existing rates were filed with the FPC under FPA § 205 (or its NGA equivalent) prior to their taking effect. *Mobile*, 350 U.S. at 336; *Sierra*, 350 U.S. at 352. The FPC retained the authority, "either upon complaint" or "upon its own initiative," to "enter upon a hearing concerning the lawfulness of such rate," and to further suspend effectiveness of the rate pending such hearing.

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[6] Petitioners' argument on this point is at odds with the position they took in their requests for rehearing at FERC, where they asked FERC to make an affirmative finding that the contracts were just and reasonable, recognizing that "[a]ll rates, terms and conditions of service must be 'just and reasonable' in order to be lawful under the FPA. . . . The *Mobile-Sierra* doctrine will not – indeed by definition cannot – countenance unjust and unreasonable rates." (ER-711, 712, 714.) Reiterating its view that it was bound to the "high burden" of the *Mobile-Sierra* standard, FERC declined to make the requested finding, as a "matter[ ] not before us in this case." Pet. App. at 36a (¶ 38).

Mobile, 350 U.S. at 334 n.1. In ruling that the seller could not later return to the Commission and unilaterally raise the previously filed rate without establishing that such an increase was somehow necessary to protect the public, the Court did not hold that the rates in the initial filing could have been insulated altogether from review. In reviewing *Mobile* and *Sierra* more recently, this Court acknowledged precisely the contrary, noting that the FPA granted to the Commission "an opportunity in every case to judge the reasonableness of the rate." *Arkla*, 453 U.S. at 582.[7]

Petitioners fare no better by pointing to decisions by other circuits in which the original contracts were never filed, and thus never subject to review. Dynegy Pet. at 16-17; Sempra Pet. at 16-17. In those cases, the party seeking abrogation of the contracts chose, in violation of the then-extant regulatory regime, not to file the contracts in the first instance. The courts in those cases simply held that such a party could not benefit from its failure to file the rate. *See, e.g., Sam Rayburn Dam Elec. Coop. v. FPC*, 515 F.2d 998, 1009 (D.C. Cir. 1975) ("*Sam Rayburn*") ("In any event, if the parties did by their conduct subsequently modify the 1950 contract, Gulf States and the FPC are bound by the modified terms, whether or not Gulf States met its responsibility of reducing the modifications to

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[7] Petitioners point to *Verizon*, 535 U.S. 467, for the proposition that Congress intended that when two "sophisticated businesses" enter an energy contract the rates are presumptively just and reasonable under the FPA. *See, e.g.*, Sempra Pet. at 4, 14 and 17; Calpine Pet. at 20. The cited language, even apart from being *dicta*, cannot be read to support the different proposition that a sophisticated buyer can be presumed to get a fair deal in a completely broken market, such as that present in California in 2001.

writing and filing them with the FPC."); *see also Borough of Lansdale v. FPC*, 494 F.2d 1104, 1117 (D.C. Cir. 1974) ("*Lansdale*").

Petitioners also assert that this Court has never required that FERC must actually review every contractually agreed-upon rate, and they cite decisions of the courts of appeals applying the *Mobile-Sierra* reasoning to rates that were in fact never reviewed. Dynegy Pet. at 16-17; Sempra Pet. at 16-17. In so arguing, Petitioners miss the point: the Ninth Circuit held only that there need be an *opportunity* for review (as there always was under the cost-based regulatory regime), not that such a review must have in fact been conducted. *See* Pet. App. at 277a-80a ("In short, FERC is correct . . . that the *Mobile-Sierra* doctrine [applies] only if a newly-entered contract remains in effect *after* there is an opportunity for plenary, 'just and reasonable' agency review." (emphasis in original)). In each of the cases cited by Petitioners, the regulatory regime in fact required an initial filing of contracts with the Commission and thus provided such an opportunity for review. *See Northeast Utils. Serv. Co. v. FERC*, 993 F.2d 937, 960 (1st Cir. 1993) (previously filed Seabrook Power Contract); *Sam Rayburn*, 515 F.2d at 1006; *Lansdale*, 494 F.2d at 1113; *Natural Gas Pipeline Co. v. Harrington*, 246 F.2d 915, 919 (5th Cir. 1957); *see also Compania de Gas de Nuevo Laredo, S.A. v. FERC*, 606 F.2d 1024, 1026, 1029 (D.C. Cir. 1979) (involving different and somewhat inapposite gas export laws).[8] The Ninth Circuit's insistence that

[8] Dynegy makes much of the fact that, unlike the other Petitioners, it actually filed its contract with FERC. Dynegy Pet. at 14. Dynegy, however, ignores that, as discussed above, FERC's rules governing its market-based rate scheme provided no opportunity for the public to seek individualized review of market-based rate agreements before they

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FERC have at least one opportunity to review the reasonableness of rates is rooted in the FPA itself, which requires that "all rates" for "any" sale of wholesale power be filed with FERC, together with all contracts that relate to such rates. *See* 16 U.S.C. § 824d; *Mobile,* 350 U.S. at 339 (affirming that, under the FPA, "the protection of the public interest [is] afforded by supervision of the individual contracts, which to that end must be filed with the Commission and made public").

In sum, neither this Court nor any court of appeals has ever held that the FPA does not require that there be at least one opportunity for meaningful review of rates that are within FERC's jurisdiction. In agreeing with FERC on this particular point, the Ninth Circuit created no conflict.

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became effective. *See, e.g., El Paso Elec. Co.,* 108 FERC at 61,372. The filing of a market-based contract was treated by FERC as merely "informational," with third parties precluded from intervening and challenging the justness and reasonableness of the rates. *See GWF Energy,* LLC, 97 FERC at 62,391. In any case, the Ninth Circuit expressly recognized that its holding would stand even if it had not rejected Dynegy's argument. *See PUC,* Pet. App. at 11a n.8 ("Even if [Dynegy's] argument succeeded on this point, it would not be sufficient to overcome the other portions of our opinion which provide independent reasons for granting PUC's petition for review."). Accordingly, certiorari on this issue would be inappropriate. *See Lewis v. Continental Bank Corp.*, 494 U.S. 472, 477 (1990) (courts should not "decide questions that cannot affect the rights of litigants in the case before them"); *Rice v. Sioux City Mem'l Park Cemetery, Inc.*, 349 U.S. 70, 74 (1955) ("[T]his Court does not sit to satisfy a scholarly interest in such issues. Nor does it sit for the benefit of the particular litigants.").

II. THE NINTH CIRCUIT DID NOT CREATE A CONFLICT WITH THE D.C. CIRCUIT IN HOLDING THAT THE GRANT OF MARKET-BASED RATE AUTHORITY WITHOUT ONGOING EFFECTIVE MARKET OVERSIGHT DOES NOT SATISFY THE FPA'S REQUIREMENT OF AN OPPORTUNITY FOR A JUST AND REASONABLE REVIEW.

The Ninth Circuit departed company with FERC over the argument that FERC's grant of market-based rate authority constituted a satisfactory "pre-determination" that the rates in all future negotiated contracts were just and reasonable. Contrary to Petitioners' claims (Dynegy Pet. at 13; Sempra Pet. at 18-22), the Ninth Circuit's ruling in this regard does not create a circuit split or mean that FERC may not under any circumstances use a market-based regulatory regime to satisfy its statutory obligations. Rather, "market-based rate authority *can* qualify as sufficient prior review to justify limited *Mobile-Sierra* review," provided it is "accompanied by effective oversight permitting timely reconsideration of market-based authorization if market conditions change." Pet. App. at 285a. Such procedures must be available to ensure that contract rates are the product of a functioning, competitive market and, therefore, can be expected to be within the zone of reasonableness. *Id.* at 303a. "Only then can FERC meet its statutory duty to ensure that *all* rates are 'just and reasonable.'" *Id.* at 287a (emphasis in original).

The Ninth Circuit found that FERC's regulatory scheme in place in 2001 did not "provide sufficient oversight for contracts made under market-based rate authority to ensure that the resulting rates were within the statutory 'just and reasonable' range in the first instance,

thereby permitting reliance on the *Mobile-Sierra* doctrine as to the continuing effectiveness of those contracts." *Id.* at 289a. However, the court's prerequisites for application of *Mobile-Sierra* provide FERC ample leeway to decide how to provide such oversight going forward.

Petitioners argue that the Ninth Circuit's decision on this point conflicts with the D.C. Circuit's decision in *Elizabethtown Gas Co. v. FERC*, 10 F.3d 866 (D.C. Cir. 1993). Sempra Pet. at 18-19; Calpine Pet. at 12. In *Elizabethtown*, FERC authorized a gas pipeline and its customers to enter into a settlement whereby the pipeline would sell gas at individually negotiated market-based rates. *Id.* at 869. The settlement was challenged on the grounds that market-based pricing violated FERC's obligation to ensure just and reasonable rates. FERC rejected the challenge because it found that the subject market was competitive and at the same time FERC expressly reserved "its § 5 authority (upon its own motion or upon that of a complainant) to assure that a market (*i.e.*, negotiated) rate is just and reasonable." *Id.* at 870-71.[9]

Here, by contrast, FERC certainly did not find the subject markets to be competitive, yet it refused to provide any opportunity to assure that the rates are just and reasonable. Here, too, the Ninth Circuit found that FERC's market monitoring was inadequate, *PUC*, Pet. App. at 10a-12a,[10] an issue not reached in *Elizabethtown*. *Cf.* 10

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[9] Sections 4 and 5 of the NGA are substantively equivalent to sections 205 and 206 of the FPA.

[10] In fact, contrary to Petitioners' claims (*e.g.*, Sempra Pet. at 6), it is essentially uncontroverted that FERC did not exercise effective market oversight during the energy crisis. And there is substantial evidence that market manipulation and tariff violations occurred on a

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F.3d at 871. The *Elizabethtown* decision does not even mention *Mobile* and *Sierra*, much less consider how those decisions would apply to any subsequent challenge based on a claim that the subject market was not competitive at the time of contract formation.

The lack of conflict is underscored by the Ninth Circuit's reliance on the same precedent relied upon by *Elizabethtown*. *Compare Elizabethtown*, 10 F.3d at 870, *with* Pet. App. at 288a-89a (both citing *Farmers Union Cent. Exch. v. FERC*, 734 F.2d 1486 (D.C. Cir. 1984), and *Texaco*, 417 U.S. 380). In *Farmers Union*, the D.C. Circuit found that FERC's market-based scheme did "not comport with FERC's statutory responsibilities" because it relied solely on market forces to drive prices into the zone of reasonableness, "[b]ut nothing in the regulatory scheme itself acts as a monitor to see if this occurs or to check rates if it does not." *Farmers Union*, 734 F.2d at 1509; *see also Interstate Natural Gas Assoc. of Am. v. FERC*, 285 F.3d 18, 34 (D.C. Cir. 2002) ("*INGAA*") (recognizing that *Farmers Union* "set great store" on "monitoring and assurance of remedies in the event of insufficient competition").

Likewise, this Court's decision in *Texaco* "bolster[s]" the Ninth Circuit's determination that FERC may not rely on a market-based methodology without adequate oversight. Pet. App. at 287a. In *Texaco*, this Court struck down an FPC order attempting to utilize a "blanket certificate procedure for small producers of natural gas" that would

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"massive scale" unchecked by any contemporaneous regulatory oversight. *See Lockyer*, 383 F.3d at 1014-15; *see also Pub. Utils. Comm'n of Cal. v. FERC*, 462 F.3d 1027, 1049 (9th Cir. 2006).

"relieve[] them of almost all filing requirements" based on the rationale that small producers' rates would be determined by market forces. *Texaco*, 417 U.S. at 382, 390. Agreeing with the D.C. Circuit, this Court concluded that the Commission's proposed "indirect regulation" of small producers through only market forces did not meet its statutory obligation because "the prevailing price in the marketplace cannot be the final measure of 'just and reasonable' rates mandated by the Act." *Id.* at 395-97.

In sum, neither this Court nor the D.C. Circuit has ever held that FERC may satisfy its statutory obligation to ensure that all rates are just and reasonable by reliance on a market-based regulatory scheme devoid of any consideration of whether the market is functioning.[11]

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[11] Sempra also suggests that, even if the grant of market-based rate authority was not always an adequate substitute for an opportunity to review the justness and reasonableness of rates, in Sempra's case the grant was in fact adequate. *See* Sempra Pet. at 19. Sempra's reasoning is that because it received its market rate authority just three weeks before it signed its contract with CDWR, FERC implicitly found that the market was functioning and hence producing reasonable rates at the time of contract formation. Sempra's argument that this peculiar chronology unique to Sempra calls for a contrary result below does not warrant review by this Court and, in any event, is incorrect. Sempra in its application for market rate authority specifically disavowed any suggestion that the market was competitive, noting that its application was "not premised on the assumption that markets in California are working efficiently or competitively under current circumstances. What [Sempra] seeks . . . [is] simply to be put on the same footing as other suppliers in California or elsewhere. . . ." Application of Sempra for Market-Based Rates, Docket No. ER01-1178-000 (Feb. 6, 2001).

III. THE NINTH CIRCUIT'S DECISIONS DO NOT CONFLICT WITH *MOBILE* AND *SIERRA* OR CREATE A SPLIT IN THE CIRCUITS AS TO HOW THE PUBLIC INTEREST STANDARD APPLIES TO A MARKET-BASED CONTRACT GOVERNED BY THE FPA.

Petitioners also dispute the Ninth Circuit's formulation of the *Mobile-Sierra* public interest test in the context of this case – a "high-rate" challenge – where the CEOB and CPUC, acting on behalf of California consumers, asked the Commission to determine whether the contracts, from the outset, imposed unjust and unreasonable rates due to the absence of a functioning and competitive market at the time they were signed. The logic behind the Ninth Circuit's reasoning is straightforward: when the *Mobile-Sierra* standard of review applies, contracts that harm the public interest must be subject to reform; harm to the public interest includes burdening the public with market-based rates that are above the zone of reasonableness at contract formation; therefore, if the rates will be borne by the public *and* the rates at contract formation are outside the zone of reasonableness, the FPA requires that FERC provide relief for the public from that burden. Pet. App. at 300a-03a.

By focusing the inquiry on the "public interest," the court's decision is entirely consistent with *Mobile, Sierra* and their progeny. "That the purpose of the power given the Commission by § 206(a) is the protection of the public interest, as distinguished from the private interests of the utilities, is evidenced by the recital in § 201 of the Act that the scheme of regulation imposed 'is necessary in the public interest.'" *Sierra*, 350 U.S. at 355; *Mobile*, 350 U.S. at 344 ("contracts remain fully subject to the paramount

power of the Commission to modify them when necessary in the public interest."); *Texaco Inc. v. FERC*, 148 F.3d 1091, 1097 (D.C. Cir. 1998) ("the public interest necessary to override a private contract . . . requires analysis of the manner in which the contract harms the public interest and of the extent to which abrogation or reformation mitigates the contract's deleterious effect"); *Boston Edison Co. v. FERC*, 233 F.3d 60, 65 (1st Cir. 2000) ("the Supreme Court said that the contract rate could be raised only if it offended the 'public interest' ").

Likewise, the Ninth Circuit's formulation of the public interest standard to address the "high-rate" circumstances of this case does not conflict with *Mobile* and *Sierra* or create a circuit split. In fashioning its test, the court correctly recognized that the particular and nonexclusive factors articulated in *Sierra* arose in the context where a utility seller sought a rate increase because the challenged rate was "too low." Pet. App. at 300a, citing *Sierra*, 350 U.S. at 355; *see also Mobile*, 350 U.S. at 345 ("And if the Commission, after hearing, determines the contract to be *so low* as to conflict with the public interest, it may under § 5(a) authorize the natural gas company to file a schedule increasing the rate.") (emphasis added).[12] In that context, the challenging utility faces a "high burden" because

[12] Petitioners misconstrue this fundamental principle of *Mobile* and *Sierra*. *Compare* MSCG Pet. at 3 (asserting that *Mobile* and *Sierra* established, *inter alia*, that "FERC may disturb a valid wholesale contract only in the rare instance when the contract is causing extensive damage to the public interest") *and* Sempra Pet. at 1 (arguing that this Court announced in *Mobile* and *Sierra* that "the FPA requires valid contracts to be enforced except in extraordinary circumstances where the contracts are contrary to the public interest") *with Sierra*, 350 U.S. at 355.

"[r]ates asserted to be *lower* than those FERC would approve *ab initio* will not ordinarily directly affect the most obvious 'public interest' underlying the FPA – namely, avoidance of unnecessarily high rates for the consuming public." Pet. App. at 300a-01a (emphasis in original).

In recognizing this distinction between the public interest factors applicable in a high-rate versus the typical low-rate context, the Ninth Circuit's decision is entirely consistent with prior decisions of the First and D.C. Circuits, and supported by the Fourth Circuit's (and the Government's) recognition of *Sierra*'s meaning in its immediate aftermath. The First Circuit in *Northeast Utils. Serv. Co. v. FERC*, 55 F.3d 686 (1st Cir. 1995) ("*Northeast II*"), expressly recognized that the *Sierra* factors are intended to apply only in the low-rate context:

> The holding of Sierra is clear; what justifies protective action in the public interest by the Commission when it is considering whether a contract rate is too low is where the rate might impair the financial ability of the utility to continue to supply electricity, force electricity consumers to bear an excessive burden, or be unduly discriminatory. This definition of what is necessary in the public interest was formulated in the context of a low-rate case. It was not and could not be an across-the-board definition of what constitutes the public interest in other types of cases.

Northeast II, 55 F.3d at 690. The D.C. Circuit likewise has made clear that *Mobile-Sierra* focused on low rates: the "doctrine broadly holds that the Commission cannot order an *increase* in rates set in a fixed-rate contract, or reject the rates on grounds they are *too low*, unless and until a

hearing has shown the rates to be lower than the public interest requires." *Lansdale*, 494 F.2d at 1114 n.43 (emphasis added).

This high-rate/low-rate distinction was the very first ramification of the *Mobile* and *Sierra* decisions recognized by the Commission and the appellate courts. In 1957, the Fourth Circuit in *South Carolina Generating Co. v. FPC*, 249 F.2d 755 (4th Cir. 1957) ("*S.C. Generating*"), reviewed an FPC order reducing the rate in a long-term contract on the grounds that it was unjustly and unreasonably high. The seller utility contracted to supply capacity to a neighboring utility for a 25-year term at a fixed price. One year after the contract was filed and accepted by the FPC, a proceeding was initiated to investigate whether the rates were just and reasonable. *Id.* at 759. After a hearing in which representatives for both utilities offered testimony supporting the contract but the Georgia public service commission opposed the contract as unfair, the FPC ordered the price reduced to a just and reasonable level. *Id.* Relying on *Mobile* and *Sierra*, decided just one year earlier, the seller challenged the FPC's authority to order this price change. *Id.*

The Fourth Circuit affirmed the FPC's order and distinguished *Mobile* and *Sierra* just as the Ninth Circuit has done here five decades later:

> [O]n examination [the sellers' argument] soon appears to be an attempt to generalize from a particular situation without recognizing the significant difference in the facts in the pending case. The Supreme Court was dealing with rates, too low to permit an adequate return according to accepted standards, which had been adopted to serve the interest of the producing utilities . . .

> but the public interest was served by the lower cost to the ultimate consumers. . . . In the pending case, to the contrary, we are dealing with a rate that was too high according to accepted standards of rate regulations. . . .
>
> We do not think that the Supreme Court denounced this accustomed procedure [i.e., just and reasonable review under section 205(e)] in the Mobile and Sierra cases when it concluded that the unusually low rates which the utilities had voluntarily set up to serve their own interests were not unjust or unreasonable; and hence the Commission in the pending case, bearing in mind that its duty is to protect the public interest as distinguished from the private interest of the utilities, and finding the contract rate is unreasonably high was justified in fixing a lower rate for the benefit of the retail consumers in Georgia after providing a reasonable return on the moneys invested by the utilities.

Id. at 761-62. This Court then denied certiorari, with the FPC's support. *South Carolina Generating Co. v. FPC,* 356 U.S. 912 (1958).[13]

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[13] The Solicitor General's rationale for opposing the grant of certiorari in 1958 remains quite apt:

> It is evident, as the Commission and the unanimous court below recognized, that this Court was not attempting to prevent regulation of contract rates, as petitioner contends, but was only protecting consumer interests and that the *Sierra* holding can have no application where, as here, the contract rates are found unjust and unreasonable – because excessive – and consequently an unwarranted burden on the ultimate consumer.

South Carolina Generating Co. v. FPC, Docket No. 57-697, Brief of the Federal Power Commission in Opposition (Feb. 13, 1958); *see also Watt*

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Nor does the Ninth Circuit's formulation of the public interest standard conflict with the D.C. Circuit's decision in *Potomac Electric Power Co. v. FERC*, 210 F.3d 403 (D.C. Cir. 2000) ("*PEPCO*"). In *PEPCO*, the buyer utility sought to reduce previously filed and approved rates charged under its transmission contract on the grounds that changed circumstances resulted in those rates significantly exceeding the current market. *Id.* at 406-07. The Commission rejected the buyer's characterization of the issue for hearing (which asked FERC to assess the justness and reasonableness of the contract rates), and "defined the issue instead to be whether the rates, *having been found to be just and reasonable when originally approved*, had become contrary to the public interest." *Id.* at 406 (emphasis added). Unlike Respondents in this case, the buyer presented no evidence that consumers would bear the burden of the rates, relying instead on "a bald claim that [its] ratepayers would derive benefit from a rate modification." *Id.* at 409. The buyer therefore lost, not because it was permissible to burden consumers with unjust and unreasonable rates or because the public interest standard was supposedly limited to the *Sierra* factors, but rather from a "failure of proof." *Id.* at 411. Moreover, even if *PEPCO* did suggest a high burden where a contract challenge is based on changed circumstances, such standard has no application where the challenge is based on the circumstances that existed at the time of contract formation.

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v. Alaska, 451 U.S. 259, 273 (1981) ("The Department's contemporaneous construction carries persuasive weight. . . . The Department's current interpretation, being in conflict with its initial position, is entitled to considerably less deference.").

Petitioners also characterize the Ninth Circuit's approach as "asymmetric," favoring buyers over sellers. Sempra Pet. at 26; Dynegy Pet. at 26. But the FPA's purpose is not to achieve symmetry; it is to protect the interests of the public. *Cf. Sunray Mid-Continent Oil Co. v. FERC*, 364 U.S. 137, 143 (1960) ("[T]he primary practical problem that led to the passage of the [NGA and FPA] was the great economic power of the [utilities] as compared with that of the communities seeking natural gas [and electric] service."). *Mobile* and *Sierra* make clear that FERC has no mandate to concern itself with protecting private interests unless doing so is necessary for the public interest. Such a differentiation in FERC's mandate not surprisingly leads to "asymmetric approaches," because determining whether an unreasonably high rate harms the public necessarily involves different considerations than determining whether an unreasonably low rate harms the public.[14] And the assertion that such asymmetry will wreak havoc on contracting is belied by the fact that the high-rate/low-rate dichotomy has been expressly recognized by the Commission and the courts for almost as long as *Mobile-Sierra* itself. *See S.C. Generating*, 249 F.2d at 762.

Contrary to Petitioners' claims, the Ninth Circuit's formulation also does not conflate the public interest test into simply a just and reasonable review. Under the court's formulation, a contract harms the public interest due to a high rate only when the rate is outside the zone of

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[14] This "asymmetry" also manifests itself in FPA § 205(e), 16 U.S.C. § 824d(e), which exhibits a "statutory bias favoring retroactive rate reductions but not retroactive rate increases. . . ." *Belco Petroleum Corp. v. FERC*, 589 F.2d 680, 687 (D.C. Cir. 1978).

reasonableness at contract formation *and* the consuming public (as opposed to simply the private buyer itself) will be forced to bear that unjust charge through retail rates. Pet. App. at 302a. This focus on the impact on the consuming public wholly comports with precedent, especially this Court's admonition that even "a small dent in the consumer's pocket" may make a rate unjust and unreasonable and therefore "unlawful." *Texaco*, 417 U.S. at 399; *see also* Pet. App. at 302a. The court's articulation of the public interest standard set forth above, which "mirrors that endorsed by the D.C. Circuit for determination of a just and reasonable rate under a market-based rate regulation regime," confirms the dual elements that a buyer must prove to obtain relief. *See id.* at 303a (citing *INGAA*, 285 F.3d at 31-36).[15]

IV. REVIEW OF THE NINTH CIRCUIT'S DECISIONS AT THIS TIME WOULD BE INAPPROPRIATE FOR PRUDENTIAL REASONS.

Petitioners' arguments concerning the effect of the Ninth Circuit's decisions on new contracts, and new contract challenges, ignore both what the Ninth Circuit said and what FERC itself has done since 2001. The Ninth Circuit recognized that "a functioning marketplace will drive prices towards marginal cost, and therefore toward

[15] The Ninth Circuit did not address, and this Court need not anticipate, the appropriate public interest test to be applied in a situation where a contract is entered into in a competitive market and later challenged by a buyer as too high. Nonetheless, the court's admonition that rates produced in a functionally competitive market are within the zone of reasonableness, *see* Pet. App. at 303a, refutes any notion that true "buyer's remorse" cases will receive any more favorable outcomes than in the past.

. . . a reasonable range, 'at least over the long pull'" and that "[e]ven if a particular rate exceeds marginal cost, . . . it may still be within this . . . 'zone of reasonableness' – if that higher-than-cost-based price results from *normal* market forces and is part of general trend towards rates that do reflect cost." Pet. App. at 303a (citing and quoting *INGAA*, 285 F.3d at 31-32) (emphasis added); *see also Tejas Power Corp. v. FERC*, 908 F.2d 998, 1004 (D.C. Cir. 1990). FERC, in turn, has modified its market-based regime by taking various actions that, in its view, provide "appropriate market safeguards . . . to prevent a repeat of the California 2000-2001 energy crisis." *CAlifornians for Renewable Energy, Inc. v. Cal. Pub. Utils. Comm'n*, 119 FERC ¶ 61,058 at ¶ 30-40 (2007) ("*CARE*").[16] FERC posits that its new regulatory regime provides the requisite assurance of market competitiveness through enhanced scrutiny at the issuance of market-based rate authority and improved market monitoring. *Id.* at ¶ 31. Future contracting and future challenges will occur in the context

[16] According to FERC, its post-crisis market reforms include: remedies for market manipulation and other market abuses; enhanced civil penalty authority; and the Office of Enforcement, created to enhance FERC's market oversight. CARE, 119 FERC at ¶¶ 32, 33, 35 & 37. Most recently, FERC issued an extensive and detailed final rule amending its market-based rate authorization regulations. Order No. 697, *Market-Based Rates for Wholesale Sales of Elec. Energy Capacity and Ancillary Servs. by Pub. Utils.*, 119 FERC ¶ 61,295 (June 21, 2007). FERC characterized this rule as "providing a rigorous up-front analysis of whether market-based rates should be granted, including protective conditions and ongoing filing requirements in all market-based rate authorizations, and reinforcing its ongoing oversight of market-based rates." *Id.* at ¶ 2. Tacitly conceding this was not so during the energy crisis, FERC also noted that "[t]he specific components of this rule, in conjunction with other regulatory activities, are designed to ensure that market-based rates charged by public utilities are just and reasonable." *Id.*

of these new rules and procedures, the adequacy of which is not at issue here.

Petitioners' argument that the Ninth Circuit's decisions will result in a flood of challenges by parties seeking to escape pre-existing contracts is belied by FERC's recent treatment of the complaints in *CARE*. The complaining party, relying upon the *PUD* and *PUC* decisions, demanded that FERC abrogate two market-based contracts entered into in 2007. *CARE*, 119 FERC at ¶ 3 (citation omitted). FERC rejected the complainants' arguments and dismissed the complaints. *Id.* at ¶¶ 41-45. As such, there is as yet not a single post-*PUD* market-based rate decision from FERC that has ordered relief.

Finally, Petitioners' dire prediction of harm to electricity markets completely ignores the necessity of fairness and integrity for the success of any market. It is axiomatic that, for a market to be both liquid and competitive, there must be confidence that the market is fair and free of manipulation. *Cf. Silver v. New York Stock Exch.*, 373 U.S. 341, 355 (1963) ("engendering in the public a loss of confidence" in a stock exchange could "significantly impair fulfillment of the Exchange's function in our economy," and regulations to reduce the risk of such harm are "just and adequate to insure fair dealing and to protect investors") (internal quotation marks and citation omitted); *Oversight Hearing on the Monetary Policy Report to Congress Pursuant to the Full Employment and Balanced Growth Act of 1978 Before the S. Comm. on Banking, Housing, and Urban Affairs*, 107th Cong. 44 (July 16, 2002) (Statement of Alan Greenspan, Chairman of the Bd. of Governors of the Fed. Reserve Sys.) ("Well-functioning markets require accurate information to allocate capital and other resources, and market participants must have confidence

that our predominately voluntary system of exchange is transparent and fair.").[17] In this important respect, the Ninth Circuit decisions facilitate the functioning of the markets in this industry.

In sum, the Ninth Circuit well applied the basic principles of the FPA and prior precedent to what no one disputes was an unprecedented market crisis under a regulatory regime that clearly did not anticipate such a crisis. FERC's post-crisis reforms to that scheme have not yet been tested in practice or in the courts. Accordingly, it makes sense to allow FERC and the circuit courts to address these issues in the first instance before this Court determines whether it need consider how best to proceed. *See, e.g., Lackley v. Texas*, 514 U.S. 1045, 1045 (1995) (Stevens, J., respecting denial of certiorari) (noting that denial of certiorari gives the opportunity to further study the disputed issue); *Virginia Military Inst. v. United States*, 508 U.S. 946, 946 (1993) (Scalia, J., respecting the denial of certiorari) (the Court "generally await[s] final judgment in the lower courts before exercising [its] certiorari jurisdiction.").

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[17] *See, e.g.*, Exh. CAL-3 at 15:14-20 ("Until [state policy makers] receive assurances that electric industry restructuring will not lead to catastrophic failure, they are unlikely to restart their restructuring efforts. FERC can provide the necessary assurance by adjusting the DWR contracts and demonstrating that, if something does go drastically wrong, there will be a remedy."); Exh. CAL-90 at 73:22-74:4 ("It appears that the public has lost confidence in the benefits of electric industry restructuring. Competitive markets have the potential to achieve a degree of efficiency not possible for regulated markets to achieve. Without assurance of adequate regulatory oversight of competitive markets, however, it appears the public will not support restructuring and without restructuring, potential competitive efficiencies will not be realized.").

CONCLUSION

For these reasons, the petitions should be denied.

Respectfully submitted,

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